IN THE COURT OF APPEALS OF TENNESSEE
AT NASHVILLE
September 13, 2007 Session

STATE FARM FIRE AND CASUALTY COMPANY, as subrogee of, GERALD SCOTT NEWELL, ET AL. v. EASYHEAT, INC., ET AL.

Direct Appeal from the Circuit Court for Williamson County
No. 06237 R. E. Lee Davies, Judge

No. M2006-02363-COA-R3-CV - Filed November 7, 2007

The trial court denied Defendant Tennessee Heritage Enterprises's motion to compel arbitration under the Federal Arbitration Act notwithstanding the arbitration clause contained in the construction contract executed by Plaintiff homeowner and Defendant. The trial court denied arbitration on the basis of insufficient interstate commerce. Defendant appeals; we reverse and remand.

Tenn. R. App. P. 3 Appeal as of Right; Judgment of the Circuit Court Reversed and Remanded

DAVID R. FARMER, J., delivered the opinion of the court, in which ALAN E. HIGHERS, J. and HOLLY M. KIRBY, J., joined.

Joseph P. Rusnak, Nashville, Tennessee, for the appellant, Tennessee Heritage Enterprises, Inc.

James L. Weatherly, Jr. And Jacqueline B. Dixon, Nashville, Tennessee, for the appellees, State Farm Fire and Casualty Company, as subrogee of, Gerald Scott Newell and Amy Marie Newell.

OPINION

This dispute concerns the applicability of the Federal Arbitration Act ("FAA") to a contract executed in Tennessee in August 2001 by Defendant Tennessee Heritage Enterprises, Inc. (THE) and Plaintiff State Farm Fire and Casualty Company's ("State Farm") insureds, Gerald and Amy Newell ("the Newells"), for construction of a home in Williamson County. The contract construction price was $883,165. The contract contained an arbitration clause and no choice of law provision. The arbitration provision contained in the contract was the final of 18 contractual terms and was placed immediately above the signature lines. It provided that "any dispute or controversy arising out of this Agreement, its performances or breach" that could not be resolved by mediation "shall be settled by arbitration[.]" Construction of the home included the installation of an electric floor tile warming system manufactured by Defendant Easyheat, Inc., a Delaware corporation headquartered in Indiana, that allegedly caused a fire resulting in substantial damage to the home in April 2003. State Farm paid damages to the Newells in the amount of $1,606,674.65 pursuant to their homeowners insurance policy. In April 2006, State Farm, as subrogee of the Newells, filed a complaint against THE and Easyheat, Inc.; EGS Electrical Group, LLC; EGS Electrical Group, LLC, d/b/a Nelson Easyheat; Emerson Electric Co.; SPX Corporation; Adam Stern Homes, Inc,; Eddie Barnes, Individually and Eddie Barnes d/b/a Barnes Electric. In its complaint, State Farm alleged defects in construction and asserted breach of warranty and several negligence claims.

In June 2006, THE filed a motion to compel binding arbitration and stay litigation pursuant to the arbitration clause in the construction contract. In its motion, THE asserted that materials used in construction of the home were assembled and/or manufactured outside Tennessee and transported to Tennessee from other states, and that several material suppliers hired by THE have their principal place of business outside of Tennessee. THE also asserted that it maintained general liability insurance for construction of the home with State Farm in Bloomington, Illinois. State Farm filed a motion opposing arbitration on the grounds that 1) the arbitration provision was not separately initialed as required by Tennessee Code Annotated § 29-5-302(a) and 2) the FAA is inapplicable because the contract did not evidence interstate commerce. The trial court denied the motion to arbitrate upon finding that the contract did not have a substantial relation to interstate commerce and that "the effect of the intrastate transactions in this contract upon interstate commerce is indirect." The trial court entered its order denying arbitration on October 24, 2006, and THE filed a timely notice of appeal to this Court pursuant to Tennessee Code Annotated § 29-5-319(a).[1] We reverse.

Issue Presented

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[1] An order denying a motion to compel arbitration is immediately appealable as a matter of right under both the Federal Arbitration Act and the Tennessee Arbitration Act. 9 U.S.C. § 16; Tenn. Code Ann. § 29-5-319(a)(1).

9 U.S.C. § 16 provides:

(a) An appeal may be taken from-
(1) an order-
(A) refusing a stay of any action under section 3 of this title,
(B) denying a petition under section 4 of this title to order arbitration to proceed,
(C) denying an application under section 206 of this title to compel arbitration,
(D) confirming or denying confirmation of an award or partial award, or
(E) modifying, correcting, or vacating an award;
(2) an interlocutory order granting, continuing, or modifying an injunction against an arbitration that is subject to this title; or
(3) a final decision with respect to an arbitration that is subject to this title.
(b) Except as otherwise provided in section 1292(b) of title 28, an appeal may not be taken from an interlocutory order-
(1) granting a stay of any action under section 3 of this title;
(2) directing arbitration to proceed under section 4 of this title;
(3) compelling arbitration under section 206 of this title; or
(4) refusing to enjoin an arbitration that is subject to this title.

Tennessee Code Annotated § 29-5-319 provides:

Appeal. – (a) An appeal may be taken from:
(1) An order denying an application to compel arbitration made under § 29-5-303;
(2) An order granting an application to stay arbitration made under § 29-5-303(b);
(3) An order confirming or denying confirmation of an award;
(4) An order modifying or correcting an award;
(5) An order vacating an award without directing a re-hearing; and
(6) A judgment or decree entered pursuant to the provisions of this part.
(b) The appeal shall be taken in the manner and to the same extent as from orders or judgments in a civil action."

Tenn.Code Ann. § 29-5-319 (2000).

The issue raised for our review, as presented by THE is:

> As the construction contract in this case evidences a transaction involving interstate commerce and contains a written arbitration provision, and inasmuch as the Federal Arbitration Act preempts state arbitration law, did the trial court err in denying the motion to compel binding arbitration and stay litigation filed on behalf of Tennessee Heritage Enterprises, Inc.?

Standard of Review

This appeal presents a question of law. We review questions of law *de novo*, with no presumption of correctness afforded to the determinations of the trial court. Tenn. R. App. P. 13(d); *Bowden v. Ward*, 27 S.W.3d 913, 916 (Tenn. 2000).

Analysis

The facts relevant to our disposition of this matter are undisputed. The question presented requires us to determine whether, as a matter of law, the contract evidences interstate commerce for the purposes of the FAA, and, if not, whether State Farm can oppose arbitration under Tennessee Code Annotated § 29-5-302(a).

In its brief to this Court, State Farm asserts the arbitration clause contained in the contract for construction in this case is not binding under Tennessee Code Annotated § 29-5-302(a) because the arbitration provision contained in the contract for construction of residential property was not separately signed or initialed by the parties.[2] State Farm further asserts the FAA is inapplicable because the transaction between the parties did not have a "substantial relation" to interstate commerce. It asserts that the interstate commerce in this case is insufficient to permit application of the FAA because THE is a Tennessee corporation with its principal place of business in Tennessee; THE has never done business outside this state; all subcontractors engaged by THE were from Tennessee; and where, although many products used in the construction of the home were manufactured out-of-state, they were not purchased from an out-of-state vendor. State Farm cites *A.L.A. Schechter Poultry Corporation v. United States*, 295 U.S. 495, a 1935 United States Supreme Court opinion, for the proposition that the materials imported into Tennessee were subject to the come-to-rest doctrine, and that the FAA is inapplicable where the materials were outside the flow of interstate commerce when purchased by THE.

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[2] Tennessee Code Annotated § 29-5-302(a) provides:

> (a) A written agreement to submit any existing controversy to arbitration or a provision in a written contract to submit to arbitration any controversy thereafter arising between the parties is valid, enforceable and irrevocable save upon such grounds as exist at law or in equity for the revocation of any contract; provided, that for contracts relating to farm property, structures or goods, or to property and structures utilized as a residence of a party, the clause providing for arbitration shall be additionally signed or initialed by the parties.

THE, on the other hand, asserts the contract involves interstate commerce where the Defendants named on the complaint, corporations responsible for the manufacture, design, testing and marketing of the floor warming system, are Delaware and Missouri Corporations with principal places of business in Indiana, Illinois, Missouri, and North Carolina. It cites *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265 (1995), in support of its argument that the contract evidences interstate commerce for the purposes of the FAA where a significant number of materials and systems used in the construction of the home were manufactured outside Tennessee. We must agree.

The FAA requires the enforcement of a written arbitration agreement in "a contract evidencing a transaction involving commerce." 9 U.S.C. § 2. In *Allied-Bruce*, the United States Supreme Court interpreted the phrase "involving commerce" broadly, holding that "involving" is the "functional equivalent of 'affecting.'" *Allied-Bruc*e, 513 U.S. 265, 273-74. Additionally, the *Allied-Bruce* court held that the FAA applies to arbitration clauses in contracts "involving" interstate commerce when interstate commerce is present in fact, regardless of whether it was within the contemplation of the parties when the contract was executed. *Id.* The Supreme Court reiterated this broad definition in *Citizens Bank v. Alafabco*, observing that the term "affecting commerce" comprises "words of art that ordinarily signal the broadest permissible exercise of Congress' Commerce Clause power." *Citizens Bank v. Alafabco*, 539 U.S. 52, 56 (2003). In *Citizens Bank*, the Supreme Court rejected the argument that the FAA is restricted to transactions "actually in commerce - that is, within the flow of interstate commerce," or which, taken alone, have a "substantial effect on interstate commerce." *Id.* (citations omitted). Rather, it observed that "the Commerce Clause gives Congress the power to regulate local business establishments purchasing substantial quantities of goods that have moved in interstate commerce." *Id.* at 57 (citing *Katzenbach v. McClung*, 379 U.S. 294, 304-305 (1964)). Additionally, as the Tennessee Supreme Court has noted, this broad interpretation is consistent with the report of the House of Representatives, which indicated that the phrase "involving commerce" did not restrict the FAA's reach or application. *Frizzell Const. Co. v. Gatlinburg, LLC*, 9 S.W. 3d 79, 83 (Tenn. 1999). "The report states that '[t]he control over interstate commerce reaches not only the actual physical interstate shipment of goods but also contracts relating to interstate commerce.'" *Id.* (citing H. R. Rep. No 96, at 1 (1924), *quoted in Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 401 n. 7 (1967)). In short, the United States Supreme Court has rejected the argument posited by State Farm that the FAA is limited to transactions that have a "substantial affect" on interstate commerce or that involve goods in the "flow of commerce." Rather, the term "involving commerce" as used in the FAA extends to the broadest reach of the Commerce Clause.

In this case, it is undisputed that a substantial number of the materials used by THE in the construction of the Newell home, including the roof shingles, lumber, windows, tile, carpet, insulation, appliances, mortar, HVAC units, wood trim, flooring, and the floor warming system at the center of this dispute, were manufactured outside of Tennessee. Further, although State Farm asserts these materials were purchased by THE after leaving the flow of commerce, the FAA clearly reaches beyond the "flow" of commerce and is applicable even where interstate commerce was not contemplated by the parties at the time the contract was executed.

We are not insensitive to the trial court's observation that virtually every modern construction contract falls within the purview of the FAA under the broad interpretation urged by THE. However, in light of the Supreme Court's holdings in *Allied-Bruce* and *Citizens Bank*, we must agree that the contract here involves interstate commerce where a substantial amount of materials used in the

Newell home were manufactured out of Tennessee by non-Tennessee entities. We agree with THE that the FAA is applicable in this case.

Holding

The arbitration provision contained in the contract executed by THE and the Newells is enforceable under the FAA where the transaction "involves" interstate commerce. In light of this holding, it is unnecessary for us to address State Farm's assertion that the provision would not be enforceable under section 302(a) of the Tennessee Arbitration Act as codified at Tennessee Code Annotated § 29-5-301, *et. seq*. if the FAA were inapplicable. We accordingly reverse the judgment of the trial court. This matter is remanded for entry of an order compelling arbitration and staying litigation of the action against THE. Costs of this appeal are taxed to the Appellee, State Farm Fire and Casualty Company, as subrogee of Gerald Newell and Amy Marie Newell.

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DAVID R. FARMER, JUDGE